Supreme Court, U. S.
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IN THE

Supreme Court of the United States

October Term, 1978

No. 78-746

EVA GROSSMANN,

Petitioner,

vs.

EDWARD S. REDINGTON, Trustee, and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

WILLIAM J. SCOTT,
Attorney General of the State of Illinois,
160 North LaSalle Street, Suite 900,
Chicago, Illinois 60601 (312) 793-3500,

Attorney for Petitioner.

FRED F. HERZOG,
Special Assistant Attorney General,

ROBERT G. EPSTEEN,
Assistant Attorney General,
160 North LaSalle Street, Suite 800,
Chicago, Illinois 60601 (312) 793-5635,

Of Counsel.

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APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 36, 37, 39, 40, 41, 42—September Term, 1977.

(Argued October 21, 1977 Decided June 12, 1978.)

Docket Nos. 77-6034, 77-6038, 77-6044, 77-6045, 77-6048, 77-6065

In the Matter of

WEIS SECURITIES, INC.,

Debtor.

GEORGE D. ALDRICH, H. WALLACE COHU, JOHN DE BRAGANCA, JAMES J. HIGGINSON, GRACE CUTTING MCGRATH, GRACE M. MCGRATH, CRAIG K. MITCHELL, EUGENE W. STETSON, JR., JEAN M. WINSLOW, SAMUEL WINSLOW, ESTATE OF PHILLIP D. HOLDEN, deceased, FIDELITY CORP., GENERAL UNITED LIFE INSURANCE CO., ALL AMERICAN LIFE & CASUALTY CO., ROBERT SLATER, EVA GROSSMAN, ARTHUR KREIZEL, and WEIS VOISIN & CO., INC. EMPLOYEES' PROFIT-SHARING PLAN AND TRUST,

Claimants-Appellants,

v.

EDWARD S. REDINGTON, TRUSTEE, and SECURITIES INVESTOR PROTECTION CORPORATION,

Appellees.

Before:

WATERMAN, MULLIGAN and TIMBERS,

Circuit Judges.

TIMBERS, *Circuit Judge:*

The chief question presented on this appeal is whether the claims of certain subordinated *lenders* to a broker-dealer now in liquidation should be enforced in accordance with the subordination agreements to which the lenders were parties, regardless of whether *customers* of the broker-dealer could show reliance on the subordination agreements. We hold that such subordination agreements must be enforced in accordance with their terms.

The appeal is from a judgment entered January 20, 1977 in the Southern District of New York, Inzer B. Wyatt, *District Judge,* 425 F. Supp. 212, which upheld the trustee's position with respect to the claims of the subordinated lenders. In so doing, Judge Wyatt reversed an order of Roy Babitt, *Bankruptcy Judge,* which had denied the trustee's motion for summary judgment. Judge Wyatt directed that the matter be remanded to the bankruptcy court for furthur proceedings consistent with Judge's Wyatt's opinion. We agree with the trustee's position as upheld by Judge Wyatt. We affirm.

I.

In summarizing those facts and prior proceedings necessary to an understanding of our rulings on the legal issues presented, we assume familiarity with Judge Wyatt's clear, comprehensive opinion cited above.

The proceedings in the district court began as an enforcement action commenced May 23, 1973 by the Securities and Exchange Commission (SEC) against Weis Securities, Inc. (Weis) pursuant to Section 21(e) of the Securities Exchange Act of 1934[1] and Section 20(b) of

1. 15 U.S.C. § 78u(e) (1970) [now Section 21(d), 15 U.S.C. § 78u(d) (1976)].

the Securities Act of 1933.[2] In that action[3] the SEC's complaint sought to enjoin Weis and certain of its officers from continuing violations of the antifraud and net capital provisions of the Exchange Act[4] and the Commission's rules thereunder.[5] The SEC's complaint also requested the appointment of a temporary receiver for the assets and the books and records of Weis.

On May 24, the day after the SEC enforcement action was commenced, the Securities Investor Protection Corporation (SIPC) filed an application in the SEC action, pursuant to § 5(a)(2) of the Securities Investor Protection Act of 1970 (SIPA),[6] requesting that the court adjudicate under § 5(b)(1) that the customers of Weis were in need of the protection afforded by SIPA and that the court appoint a trustee and an attorney under § 5(b)(3). See *SEC* v. *Alan F. Hughes, Inc.,* 461 F. 2d 974 (2 Cir. 1972).

On May 30 the court (then District Judge, now Circuit Judge, Murray I. Gurfein) made the requested adjudica-

2. 15 U.S.C. § 77t(b) (1970) [now Section 20(b), 15 U.S.C. § 77t(b) (1976)].

3. The jurisdictional underpinning for the action is provided in Section 27 of the Exchange Act, 15 U.S.C. § 78aa (1976), and Section 22(a) of the Securities Act, 15 U.S.C. § 77v(a) (1976).

4. Sections 10(b) and 15(c)(3), 15 U.S.C. §§ 78j(b) and 78o(c)(3) 1976).

5. Rules 15c3-1, 17a-3, 17a-4, 17a-5 and 17a-11, 17 CFR §§ 240.15c3-1, 240.17a-3, 240.17a-4, 240.17a-5, 240.17a-11 (1977).

6. 15 U.S.C. § 78eee(a)(2) (1976).

Unless otherwise indicated, all citations to SIPA are to sections thereof, as here, e.g., to § 5(a)(2). SIPA has been codified at 15 U.S.C. §§ 78aaa-78lll (1976).

tion. He appointed Edward S. Redington as trustee to oversee the orderly liquidation of the remaining assests of Weis. The proceedings in which Mr. Redington was appointed as trustee are more fully set forth in *Exchange National Bank of Chicago* v. *Wyatt,* 517 F. 2d 453, 455 (2 Cir. 1975) (Friendly, *J.*).

Backing up for a moment, during the period from June 28, 1967 to May 7, 1973, each of the lenders here involved entered into agreements with Weis which subordinated their accounts with, or loans to, Weis, to the claims of all creditors of Weis—both then existing creditors and future ones as well. In connection with all such subordination agreements the lenders submitted for approval written applications to the Board of Governors of the New York Stock Exchange (NYSE), together with opinions of counsel stating that the subordination agreements were valid and enforceable.

In consideration of the added risks inherent in the subordination, the agreements provided that the lenders were to receive interest at attractive rates on the principal amounts of the loans. As a group, the lenders received under the subordination agreements approximately $750,000 in interest.

The subordination agreements were important in that they enabled Weis to comply with the net capital rules of the SEC[7] and of the NYSE,[8] and thus to continue to deal

7. Rule 15c3-1(a) under the Exchange Act, 17 CFR § 240.15c3-1(a) (1977), provides:

"No broker or dealer shall permit his aggregate indebtedness to all other persons to exceed 1500 percentum of his net capital, except as otherwise limited by the provisions of subparagraph (a)(1), or, in the case of a broker or dealer electing to operate pursu-

(Footnote continued on next page)

with the public. The purpose of the net capital rules is "to require that the capital position of a broker or dealer will always be sufficiently liquid to cover his current indebtedness, in order to be able at all times to promptly

(Footnote continued from preceding page)

ant to paragraph (f) of this section, no broker or dealer shall permit his net capital to be less than 4 percent of aggregate debit items as computed in accordance with § 240.15c3-3a of this Chapter, except as otherwise limited by paragraph (f) of this section, and every broker or dealer shall have the net capital necessary to comply with the following conditions, except as otherwise provided for in paragraph (f) of this section."

8. NYSE Rule 325 in relevant part provides:

"(a) Each member or member organization subject to Rule 15c3-1 promulgated under the Securities Exchange Act of 1934 shall comply with the capital requirements prescribed therein and with the additional requirements of this Rule 325.

(b) Each member or member organization subject to this Rule shall forthwith notify the Exchange if his or its net capital after deduction of all capital withdrawals including maturities, if any, scheduled during the next six months, falls below the pertinent percentage indicated below:

1. If the net capital minimum dollar amount requirement is applicable—150 percent thereof or some greater percentage as may from time to time be designated by the Exchange, or
2. If the ratio of aggregate indebtedness to net capital is applicable—10 percent of aggregate indebtedness, or
3. If the specified percentage of the aggregate debit items in the Formula for Determination of Reserve Requirements for Brokers and Dealers under Securities and Exchange Commission Rule 15c3-3 is applicable—7 percent of the aggregate items thereunder. . . ."

meet the demands of customers." Securities Exchange Act Release No. 8024 (Jan. 18, 1967). Specifically, the net capital rules limit the aggregate indebtedness of regulated member firms to fifteen times their net capital. If the appropriate ratio is not met, the broker or dealer may not continue operations. In computing a firm's net capital (net worth minus nonliquid assets), subordinated property is not treated as a liability against the firm, but as an unencumbered capital asset. This treatment of subordinated property as an unencumbered asset is predicated on the assumption that such property is readily available to satisfy customers' claims.

In the instant case, the subordination agreements constituted a substantial part of Weis' net capital. As such, they were a *sine qua non* of Weis' compliance with the net capital rules and of the firm's being permitted to continue to deal with the public.

After Weis' fraud was disclosed, the lenders attempted to rescind their subordination agreements. They claimed that they had been fraudulently induced to enter into the agreements in violation of common law and the Exchange Act.[9] Such rescission, if permitted, would have placed the lenders in the same position in the liquidation proceeding as unsubordinated creditors and customers.

The trustee moved in the bankruptcy court for summary judgment to enforce the subordination agreements on the ground that the lenders were estopped from rescinding the agreements, regardless of whether customers and general creditors had relied on the agreements. For purposes of the motion, it was assumed that Weis fraudulently had induced the lenders to enter into the agreements.

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9. Section 10(b), 15 U.S.C. § 78j(b) (1976), and Rule 10b-5, 17 CFR § 240.10b-5 (1977).

In an opinion filed July 16. 1976 the bankruptcy judge denied the trustee's motion. The judge held that reliance by customers and creditors would give rise to an estoppel which would bar rescission; but whether there had been such reliance was a question of fact which precluded summary judgment. From the order entered in the bankruptcy court on August 23, 1976 denying summary judgment, the trustee appealed to the district court.

In an opinion filed January 20, 1977, Judge Wyatt reversed the bankruptcy court's denial of summary judgment, holding that reliance by customers and creditors, if necessary at all, should be conclusively presumed as a matter of law; and that the subordination agreements should be enforced according to their terms in distributing the assets of Weis. *In the Matter of Weis Securities, Inc.*, 425 F. Supp. 212, 217 (S.D.N.Y. 1977).

For reasons stated more fully below, we agree with Judge Wyatt that *customers* of Weis need not show reliance on the subordination agreements to prevent rescission by the lenders. Since the remaining assets of Weis will be exhausted after satisfaction of the customers' claims, it is unnecessary to reach the question whether *general creditors* must prove reliance in order to prevent rescission. We find no merit in the separate claims raised by several of the appellants referred to below. We affirm the judgment of the district court in all respects.

II.

In the light of the foregoing summary of the facts and prior proceedings, we turn directly to the issue which is common to all appellants:[10] whether the claims of subordi-

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10. We shall discuss below the separate claims raised by appellants Eva Grossman; Weis, Voisin & Co., Inc. Employees' Profit-Sharing Plan and Trust; and Fidelity Corporation.

nated lenders to a federally regulated broker-dealer now in liquidation should be enforced in accordance with the subordination agreements to which the lenders were parties, regardless of whether customers of the broker-dealer could show reliance on the subordination agreements as a condition to estopping the lenders from rescinding the agreements on grounds of fraud.

The lenders contend that they may not be prevented from rescinding on the basis of fraud unless the customers can show reliance on the situation that turns out to be fraudulent. We recognize that proof of detrimental reliance may be a prerequisite to the application of the doctrine of estoppel. *E.g., Fey* v. *Walston & Co., Inc.*, 493 F. 2d 1036, 1050 (7 Cir. 1974); *Royal Air Properties, Inc.* v. *Smith*, 333 F. 2d 568, 570 (9 Cir. 1964). In this Circuit, the principle was applied in *In re Credit Industrial Corp.*, 366 F. 2d 402 (2d Cir. 1966). There junior creditors sought priority in a bankruptcy proceeding because of the illegality of the agreement under which they had subordinated their interests. We stated the standard for requiring reliance as follows:

> "Reliance may become a relevant factor where equitable considerations require its consideration, namely, where the subordination agreement itself is invalid. . . . When a junior creditor establishes that the subordination agreement is unlawful, *it may be reasonable and necessary*, if equity is to be done, to require a senior creditor to prove that he relied on the subordination agreement, without actual or constructive knowledge of any infirmity in the agreement, in advancing funds to the bankrupt as a condition to receiving priority in the distribution of the bankrupt's estate. In cases where the underlying subordination agreement is unlawful, a court is not confronted with the problem of enforcing express contractual provisions but, rather, with the entirely separate problem of determining which general creditors should bear a loss caused by the debtor, a problem which *may* have to be resolved by reference to equitable principles." (emphasis added) (citations omitted).

Id. at 409.

Unlike *Credit Industrial Corp.*, however, the instant case involves the attempted rescission of a promise or obligation intended to allow a company to satisfy regulatory requirements and of promises made by the company to regulatory authorities. We therefore have an additional factor —regulatory interest—to consider in determining whether it is here "reasonable and necessary" to require reliance on the subordination agreements. Our inquiry must focus on whether the element of reliance has any place in the regulatory scheme of Congress.

In this connection we find relevant, as the district court did, a series of cases arising under the National Banking Act. Prior to 1959, shareholders of a national bank were statutorily liable for all obligations of the bank to the extent of the par value of their shares.[11]

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11. Section 63 of the National Banking Act, 12 U.S.C. § 63 (1958) [repealed in 1959], in relevant part provided:

> "The shareholders of every national banking association shall be held individually responsible . . . for all contracts, debts, and engagements of such association, to the extent of the amount of their stock therein, at the par value thereof, in addition to the amount invested in such shares. . . ."

The lenders argue that this statute is distinguishable from the federal securities laws in that the former's "clear language" imposed an "absolute liability" on the stockholders. There is no basis for this distinction. The National Banking Act did not refer to the fraudulent inducement of contributions to required capital amounts any more explicitly than the Exchange Act does.

In *Scott* v. *Deweese,* 181 U.S. 202 (1901), such a shareholder sought to rescind his purchase of bank stock on the ground that he had been fraudulently induced by the bank to buy his shares. The Court held that he was estopped from doing so on the ground that one who purchased bank shares must be conclusively presumed to have known that he had increased the bank's capital and had facilitated its conduct of business. *Id.* at 212. The Court was careful to point out that the congressional policy reflected in the statute required a bright-line delineation of priority:

> "The present suit is primarily in the interest of creditors of the bank. It is based upon a statute designed not only for their protection but to give confidence to all dealing with national banks in respect of their contracts, debts and engagements(as well as to stockholders generally. If the subscriber became a shareholder in consequence of frauds practised upon him by others, whether they be officers of the bank or officers of the Government, he must look to them for such redress as the law authorizes, and is estopped, as against creditors, to deny that he is a shareholder, within the meaning of section 5151, if at the time the rights of creditors accrued he occupied and was accorded the rights appertaining to that position."

Id. at 213. Whether the bank creditor had relied on the bank's capitalization was irrelevant. *Accord, Anderson* v. *Cronkleton,* 32 F. 2d 170, 172-73 (8 Cir. 1929) ("The statute . . . serves a general public purpose, viz., to give stability to the national banking system . . . . If stockholders were permitted to show . . . , in order to escape liability under the statute, that they became stockholders through fraud . . . the foundation of a national bank would be undermined, and its public function impaired.") *Cf.*

Hurd v. *Kelley,* 78 N.Y. 588, 597 (1879) (same with respect to a New York state bank).[12]

In these cases the courts recognized a legislative intent to encourage the public transactions upon which the well-being of the economy largely depends by bolstering public confidence in the integrity of financial institutions. To assure creditors that they could rely on the stated capital resources of a bank, the legislature compelled those who had contributed capital to stand by their commitments. In order faithfully to effectuate the legislative policy, the courts held that no condition should be placed on the creditors' priority; they concluded that shareholders were absolutely estopped from rescinding their obligations.

The same legislative solicitude for the interests of customers is present in the instant case. As stated above, pursuant to its congressional mandate to police the integrity of the nation's securities markets, the SEC has promulgated a rule which makes the ability of a securities broker to conduct business contingent upon the main-

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12. *Oppenheimer* v. *Harriman National Bank & Trust Co.,* 301 U.S. 206 (1937), relied upon by the lenders, is not to the contrary. There the Court held that a defrauded stockholder was entitled to rank on a parity with other unsecured creditors. *Id.* at 215. However, this right was held to have accrued only after vindication of regulatory interests by his payment of the statutory liability to those creditors:

> "Plaintiff appeared by the bank's records to be a stockholder and, as against creditors for whose benefit the statutory liability was created, was estopped from denying that status. Recognizing that the bank's fraud and his rescission availed nothing against the comptroller's assessment, plaintiff paid the amount laid against him." *Id.* at 214.

tenance of certain capital levels. In the same net capital rule, the SEC has proscribed the rescission of subordinated loan agreements "by mutual consent or otherwise."[13] At least to the same extent as under the National Banking Act, the regulatory authorities here are motivated by a strong desire to assure investors of the stability and integrity of the securities markets and of the broker-dealers responsible for channeling investments into them. As with the courts which interpreted the National Banking Act, we find no suggestion of a congressional intent to make the priority to which customers of a broker-dealer are entitled contingent on anything—and certainly not on the necessity of proving reliance on specific elements of a broker-dealer's assets. In short, we decline to blur the bright-line rule fashioned to further a public objective of the utmost importance.

Our holding in this respect is grounded on considerations of sound public policy. As the SEC points out in its excellent brief, to require proof of actual reliance would exacerbate the problem of impermanent capital in the brokerage community—one of the more significant causes of broker-dealer failures during the 1969-70 period. Study of Unsafe and Unsound Practices of Brokers and Dealers, H.R. Doc. No. 231, 92d Cong., 1st Sess. 49 (1971). Moreover, there would be continuing uncertainty as to the financial responsibility of broker-dealers whose capital rests on subordination agreements.

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13. Rule 15c3-1d(c)(1), 17 CFR § 240.15c3-1d(c)(1) (1977).

Weis was not formally subject to this rule because the SEC found that it was subject to NYSE Rule 325, which is even more comprehensive than the SEC rule. Securities Exchange Act Release No. 3617, Nov. 8, 1944).

In view of these considerations, sanctioning a reliance requirement in the instant case would be inconsistent with *In re Credit Industrial Corp., supra.* Proof of reliance here clearly is not "reasonable or necessary." 366 F. 2d at 409. To hold otherwise, in the asserted exercise of our equitable powers, would be contrary to public policy.

We hold, under this section of our opinion, that where a lender subordinates his loan to a securities broker—to enable the broker to comply with regulatory capital requirements—he is estopped from rescinding the subordination agreement. Whether customers relied on the subordination agreement is irrelevant. We affirm Judge Wyatt's holding on this issue.

III.

We turn next to the separate claims raised by certain of the appellants. See note 10, *supra.*

(A) Claim of Appellant Eva Grossman

First, Mrs. Grossman contends that, because of her asserted lack of sophistication in financial matters, as a lender she should have been treated differently from the other lenders by the district court. She works as a fitter in a Chicago department store. She says that when she purchased 20,000 of Weis subordinated debentures she did not fully understand the benefits and risks of her investment. She concedes that she did know that her investment as a loan to Weis would return about the highest rate of interest of any investment she could make. At oral argument before us, her attorney acknowledged that she had received several thousand dollars in interest during the six years she had owned the debentures prior to the liquidation of Weis. She nevertheless argues that, because of her peculiar lack of sophistication, she never became

a party to a subordinated debenture agreement; and that she actually was a general creditor or customer of Weis within the meaning of § 6(c)(2)(A)(ii) of SIPA.[14] We find no merit in this contention and hold that there is no basis for treating Mrs. Grossman any differently than the other lenders.

Second, Mrs. Grossman contends that, since all the assets of Weis, Voisin, Cannon Inc. (the predecessor of Weis) were transferred to Weis without notice to her, such transfer violated the Illinois and New York Bulk Sales Acts. Ill. Rev. Stat. ch. 26, §§ 6-101 et seq.; N.Y. U.C.C. §§ 6-101 et seq. If the Bulk Sales Acts were applicable, noncompliance with their terms would render the transfer voidable at Mrs. Grossman's option. *Corrigan* v. *Miller*, 338 Ill. App. 212, 217, 86 N.E. 2d 853, 856 (1949). We hold, however, that neither Bulk Sales Act is applicable here. Both Acts are intended to apply only to enterprises "whose principal business is the sale of merchandise from stock. . . ." N.Y. U.C.C. § 6-102(3); Ill. Rev. Stat. ch. 26 § 6-102(3). Weis was a broker engaged in transactions which involved investment securities. It did not sell goods or merchandise. See N.Y. U.C.C. § 8-102; Ill. Rev. Stat. ch. 26, § 8-102. We therefore find no merit in this contention.

Third, Mrs. Grossman contends that under common law the funds which she says Weis fraudulently induced her to subordinate are held by Weis and its successors under a constructive trust for her benefit. It is elementary, however, that before a constructive trust may arise, there must be a *res*—a segregated fund or property—to which the trust can attach. *A.L.I., Restatement of Restitution § 160. comment i (1937)*. Here there was nothing more than the opening of an account for Mrs. Grossman. No funds were

14. 15 U.S.C. § 78fff(c)(2)(A)(ii) (1976).

segregated for her account. Absent a *res*, there could be no constructive trust. We therefore find no merit in this contention.

We have carefully considered the other arguments urged by Mrs. Grossman and find them to be without merit.

(B) Claim of Appellant Weis, Voisin & Co. Inc. Employees' Profit-Sharing Plan and Trust

Weis, Voisin & Co. Inc. Employees' Profit-Sharing Plan and Trust (the Trust) is a tax-qualified retirement plan which provided part of the compensation, paid by Weis in the form of contributions, for eligible Weis employees. The Trust used these funds to extend a total of $95,000 in subordinated loans to Weis. Under the terms of the liquidation of Weis, the Trust will be terminated and the employees will receive a distribution of their interest in its assets.

The Trust contends that the subordinated loans it made to Weis are in substance wages owed by Weis, through the Trust, to eligible former employees. Accordingly, it asks us to accord to such loans the priority status conferred on "wages" by Section 64(a)(2) of the Bankruptcy Act, 11 U.S.C. § 104(a)(2) (1976).

The district court held, 428 F. Supp. at 219, that the term "wages" in this context is limited to "money directly due [employees] in back wages", citing *United States* v. *Embassy Restaurant*, 359 U.S. 29, 32 (1959); and that a contract whereby an employees' trust loans money to an employer at higher than normal interest rates in consideration of subordination is not within the classic pattern of "back wages". We agree.

(C) Claim of Appellant Fidelity Corporation

On January 21, 1971, Fidelity Corporation (Fidelity) entered into an agreement with Weis pursuant to which

Fidelity extended a $1,000,000 loan in consideration of a subordinated promissory note and an undertaking by Weis to sell insurance exclusively for Fidelity. Beginning October, 1972 Weis sold insurance for others in violation of this agreement. On October 12 Weis entered into a new agreement with Fidelity to repay the entire loan on November 2, 1972. When the repayment became due, Weis refused to pay it.

Fidelity contends that it may claim rescission of its subordination agreement, not only on grounds of fraud, but also on grounds of material breach of contract and failure of consideration. It urges that it should be treated as an unsecured general creditor. Alternatively, it contends that the new unsubordinated agreement of October 12 should place it in the position of a general creditor.

We hold that Fidelity, whose claim is conditioned upon a subordination agreement, is in the same position as the other lenders; and that its arguments based on breach of contract and failure of consideration are without merit.

We have carefully considered all claims of all appellants, and we find them without merit.

Affirmed.

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the seventh day of August, one thousand nine hundred and seventy-eight.

Present:

HON. STERRY R. WATERMAN
HON. WILLIAM H. MULLIGAN
HON. WILLIAM H. TIMBERS
Circuit Judges.

———————X

On the Matter of Weis Securities, Inc.,
Debtor

Claims of Docket No. 77-6034

EVA GROSSMANN, ALL AMERICAN LIFE & CASUALTY CO., GENERAL UNITED LIFE INSURANCE CO., ROBERT E. SLATER, GEORGE ALDRICH, H. WALLACE COHU, JOHN DEBRAGANCA, JAMES J. HIGGINSON, GRACE CUTTING McGRATH, GRACE M. McGRATH, CRAIG K. MITCHELL, EUGENE W. STETSON, JR., JEAN M. WINSLOW, SAMUEL WINSLOW, MICHAEL HALE HOLDEN CHEMICAL BANK, FIDELITY CORP., WEIS, VOISIN & CO., INC., EMPLOYEES' PROFIT SHARING PLAN & TRUST, ARTHUR J. KREIZEL OF STOWE, VT., Claimant-Appellants

EDWARD REDINGTON, TRUSTEE & SECURITIES INVESTOR PROTECTION CORP., Appellees.

———————X

A petition for a rehearing having been filed herein by counsel for the Claimant-appellant, Eva Grossman,

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

s/ A. DANIEL FUSARO,
A. DANIEL FUSARO,
Clerk.

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the seventh day of August, one thousand nine hundred and seventy-eight.

———————X

In the Matter of Weis Securities, Inc.,
Debtor

Claims of Docket No. 77-6034

EVA GROSSMANN, ALL AMERICAN LIFE & CASUALTY CO., GENERAL UNITED LIFE INSURANCE CO., ROBERT E. SLATER, GEORGE ALDRICH, H. WALLACE COHU, JOHN DEBRAGANCA, JAMES J. HIGGINSON, GRACE CUTTING McGRATH, GRACE M. McGRATH, CRAIG K. MITCHELL, EUGENE W. STETSON, JR., JEAN M. WINSLOW, SAMUEL WINSLOW, MICHAEL HALE HOLDEN CHEMICAL BANK, FIDELITY CORP., WEIS, VOISIN & CO., INC., EMPLOYEES' PROFIT SHARING PLAN & TRUST, ARTHUR J. KREIZEL OF STOWE, VT., Claimant-Appellants

EDWARD REDINGTON, TRUSTEE & SECURITIES INVESTOR PROTECTION CORP., Appellees.

———————X

A petition for rehearing containing a suggestion that the action be reheard en banc having been filed herein by counsel for the Claimant-appellant, Eva Grossman, and no active judge or judge who was a member of the panel having requested that a vote be taken on said suggestion,

Upon consideration thereof, it is

Ordered that said petition be and it hereby is DENIED.

s/ IRVING R. KAUFMAN,
IRVING R. KAUFMAN,
Chief Judge.

In the Matter of WEIS SECURITIES, INC., Debtor.

Claims of George D. ALDRICH, et al.

No. 73 Civ. 2332.

United States District Court,
S. D. New York.

Jan. 20, 1977.

WYATT, District Judge.

These are two appeals from an order of Bankruptcy Judge Babitt filed August 26, 1976. Appellants are (a) the trustee for the liquidation of the business of Weis Securities, Inc. (Weis) under the Securities Investor Protection Act of 1970 (SIPA, 15 U.S.C. § 78aaa and following) and (b) the Securities Investor Protection Corporation (SIPC). The order appealed from denied a motion of the trustee for summary judgment sustaining his objections to the claims of 24 different claimants who were subordinated lenders to Weis (sometimes called "claimants" and sometimes "subordinated lenders"). A thoughtful opinion had been filed by the Bankruptcy Judge on July 16, 1976. I am persuaded, however, that the able Bankruptcy Judge was in error and that the order appealed from must be reversed.

1

Weis had been a prominent registered broker-dealer and a member of the New York Stock Exchange.

The proceedings in which the trustee was appointed are described in *Exchange National Bank* v. *Wyatt*, 517 F. 2d 453 (2d Cir. 1975). The trustee was appointed on May 30, 1973; the "filing date" (15 U.S.C. § 78eee(b)(4)(B)) was May 24, 1973. Weis was in liquidation under SIPA.

2

The securities business is much regulated, necessarily so after the 1929 stock market crash and the conditions which preceded it.

The Securities Exchange Act of 1934 (15 U.S.C. § 78a and following; the 1934 Act) required brokers to have a certain amount of capital. Section 8(b) of the 1934 Act (15 U.S.C. § 78h(b)) required that the capital of a broker firm be at least 1/20 the amount of the total indebtedness of the broker firm. Expressed another way, the 1934 Act was designed to protect the customers of a broker against his insolvency; this was to be done, among other ways, by preventing him from borrowing more than twenty times his net capital.

The New York Stock Exchange had its own rule as to net capital requirements. This was its Rule 325 which provided that the indebtedness of a member could not be more than 15 times the net capital of such member.

In 1938, the 1934 Act was amended to give the SEC authority to issue regulations with respect to the "financial responsibility" of brokers. 15 U.S.C. § 78o(c)(3). The SEC issued a regulation (17 CFR § 240.15c3-1) which provided that no broker could have indebtedness of more than 20 times his net capital. Because the New York Stock Exchange rule was more restrictive than this, the SEC reguation was not applicable to members of that Exchange. Weis was a member of the New York Stock Exchange.

3

In meeting the net capital requirements of the SEC and of the Exchange, the practice developed of brokers borrowing money on a subordinated basis, that is, the lenders

agreed that their claims would be subordinated to general creditors. Where such agreements were approved by the Exchange, the indebtedness was excluded in calculating compliance with the net capital rule of the Exchange. This was an explicit provision of Rule 325(b)(2)(E) of the Exchange, which excluded from the aggregate indebtedness of a member "liabilities subordinated to general creditors pursuant to a separate agreement approved by the Exchange". In substance the subordinated loans, with the knowledge of the lenders, were used as capital for purposes of the net capital rules.

Weis, in attempting to comply with the net capital rules, borrowed from lenders who agreed that their claims would be subordinated to the general creditors of Weis. Also Weis had in 1969 bought certain assets from another broker-dealer, Winslow, Cohu & Stetson Incorporated ("Winslow"). Winslow was a member of the New York Stock Exchange and had borrowed from subordinated lenders.

It should be obvious, but may bear mentioning, that subordinated lenders are paid for the added risks which they knowingly assume. They receive all income from all securities loaned, in addition to interest at rates usually above normal. Here, for example, Weis undertook to pay 10% interest to most of the lenders and not less than 8%. We are told that in fact Weis paid $750,000 to these lenders before the trustee was appointed.

4

After the trustee was appointed for Weis on May 30, 1973, claims were filed by some 50 subordinated lenders to Weis.

On April 24, 1974, the trustee filed an "application for an order confirming the trustee's position with respect to

claims of subordinated lenders". This position was that the subordination agreements should be enforced in accordance with their terms, that claims of fraud by the subordinated lenders even if proved would not avoid the subordination agreements because every customer and creditor of Weis had relied on those agreements "either expressly or constructively", and that the claims of subordinated lenders to Weis should not be paid until the general unsecured creditors of Weis had been paid in full.

On April 24, 1974, Judge Babitt made and filed an order requiring the subordinated lenders and SEC and SIPC to show cause why the trustee's position should not be sustained.

This order to show cause was heard on July 16, 1974. Many of the subordinated lenders did not appear to oppose the position of the trustee. As to these, there was an "inquest" and the trustee's position as to them was sustained and this proceeding is no longer concerned with them.

As to 24 subordinated lenders who opposed the trustee's position, objections to their claims were then served by the trustee and filed on December 12, 1974.

Judge Babitt then made an order on December 13, 1974 requiring the 24 subordinated lenders to show cause why summary judgment should not be granted on the objections of the trustee to their claims and why the trustee's position should not be confirmed.

The hearing on this order to show cause was held on March 12, 1975.

On July 16, 1976, Judge Babitt filed his opinion and on August 26, 1976, the order here appealed from was filed. The order denied the trustee's motion.

Each of the subordination agreements here in question was made with knowledge that the money (or property) loaned would be used as capital of Weis for satisfying the provisions of the net capital rules. Each provided that in any liquidation of Weis, the loan would not participate in any distribution of Weis assets until the claims of all general creditors of Weis were satisfied. Each of these lenders submitted an application to the Exchange for approval as a subordinated lender. Each of the agreements was filed with the Exchange. Each was approved by the Exchange for inclusion of the borrowed money or property in calculating the capital of Weis to determine compliance with the net capital rules. None of this was disputed before the Bankruptcy Judge. One of the subordinated lenders sought to avoid the substance of his agreements by a statement that he was "unfamiliar with such requirements" of the Exchange (Slater aff. ¶ 4). Another stated that while the papers were signed and completed for the Exchange, the details were handled by Weis (Gardner aff. ¶ 4).

Now the subordinated lenders seek to avoid their subordination agreements by the claim that they were induced by the fraud of Weis to enter into those agreements. They thus ask in effect or expressly for rescission of their agreements and return of what they loaned to Weis.

The trustee contends that even if fraud on the subordinated lenders be assumed, these lenders are estopped as a matter of law to assert it because those of the public who dealt with Weis and who are now general creditors relied on compliance by Weis with the net capital rules and such compliance was made possible only by the agreements to subordinate. The trustee also contends that the

subordination provisions were promises to the Exchange which relied on them in allowing Weis to continue as a member and to deal with those who thereby became general creditors in the present liquidation.

6

In denying the trustee's motion, Judge Babitt ruled that actual reliance by the general creditors on the subordination agreements or net capital rule must be proved by the trustee in order to defeat the claims of fraud by the subordinated lenders. Judge Babitt also ruled that if the trustee can establish "an independent contract" between the subordinated lenders and the Exchange, "that contract will remain in force regardless of any fraud perpetrated by Weis".

It is far from clear how the ruling of the Bankruptcy Judge is intended to be applied. Must the trustee prove actual reliance by each customer creditor? Would failure to prove actual reliance by any *one* customer creditor mean that the subordination agreements could be rescinded as against all customer creditors or only as to that one customer creditor as to whom there was failure of proof? We are told by the trustee that there were 30,000 customers of Weis and by SIPC that there were 33,000 such customers. Would the trustee be required to prove actual reliance on each one of the subordination agreements of each subordinated lender? What would be the effect of a failure of proof as to one subordination agreement of one subordinated lender?

Normally these questions would be reached only after a trial of the fraud issue as to each subordinated lender and after at least one subordinated lender had established fraud by Weis. As to any subordinated lender who fails to

prove fraud by Weis, the inquiry would normally be ended and the subordination agreement could be enforced according to its terms.

It seems, however, that the Bankruptcy Judge has in mind a reversal of this order of events. The trustee is first to prove reliance by the customer creditors. If he can do this, then proof of fraud will not be taken because irrelevant. If the trustee does not prove reliance, then the fraud issue is then to be tried as to each subordinated lender. If this be the contemplated procedure it seems illogical and unworkable.

It is not clear exactly what procedure is contemplated. However, the practical result of the ruling of the Bankruptcy Judge is clear. The burden of proof on the trustee could not be met as a practical matter and thus the subordination agreements, on the strength of which Weis had been allowed to continue operating and to create claims of general creditors, could not be enforced.

7

Judge Babitt concluded that "the controlling case" is *In re Credit Industrial Corp.*, 366 F. 2d 402 (2d Cir. 1966). It is believed that this conclusion is mistaken.

CIC, a commercial finance company, obtained its working capital by borrowing from (a) institutions and (b) individuals. The individual lenders were paid " a high rate (10%-12%) of interest" but their loans were agreed to be subordinated to institutional loans and not to be paid until CIC paid all its obligations to institutional lenders. CIC became a bankrupt. Its trustee sought to enforce the subordination agreement. The individual lenders asserted several *separate* defenses, two of which are significant here: (a) that the institutions did not lend to CIC in reliance

on the subordination agreement and (b) that fraud was practiced on the individual lenders. The District Court had affirmed the denial of a motion to strike the defense described in (a) and the granting of a motion to strike the defense described in (b). The District Court believed that any subordination agreement, however valid or lawful, could only be enforced in bankruptcy if actual reliance on the agreement by senior creditors could be shown. Under this belief, it was irrelevant whether fraud could be proved by the subordinated (individual) lenders because, whether there were fraud or not, reliance by the senior (institutional) lenders had to be shown.

The Court of Appeals reversed, holding that in bankruptcy the Court "must enforce lawful subordination agreements according to their terms" (366 F. 2d at 410). Therefore, the separate defense described in (a) above should have been struck.

It was also held that the separate defense of fraud described in (b) above should not have been struck because the pleading stage was too early to decide whether proof of fraud would avail the subordinated (individual) lenders; this "should await such disposition as the law and facts require after the relevant facts have been developed" (366 F. 2d at 412).

The Court of Appeals did discuss but *did not decide* whether reliance must be shown to overcome a defense of fraud asserted by junior creditors. Such a defense was allowed to be asserted as a matter of pleading because it "*may* become important to the rights of junior creditors" (366 F. 2d at 410-11; emphasis supplied); therefore "the noteholders here are entitled to assert" such a defense in their pleading (366 F. 2d at 411). Elsewhere the Court of Appeals said: "Reliance *may* become a relevant factor . . .

where the subordination agreement itself is invalid" (366 F. 2d at 409; emphasis supplied).

There was thus no decision by the Court of Appeals on the point here at issue; the discussion was dicta, and the decision is not controlling in the case at bar.

In any event, the situation in *CIC* was radically different from that at bar. In *CIC*, the subordination ran in favor of particular, described senior creditors and the motives for subordination were entirely private, having nothing to do with statutory requirements for a regulated business. In the case at bar, Weis and the subordinated lenders knew that the subordination was to meet the statutory requirements for a broker-dealer to continue in business and knew that it was for the protection of the general class of Weis customers who, as long as Weis continued to operate, were becoming general creditors of Weis.

8

There is not only no controlling authority on the point here at issue; there are no decisions on the point.

[1, 2] We must consider, therefore, what equity and fairness would suggest. This seems clearly to be that, as between the customer and other general creditors of Weis on the one hand (for whom the trustee speaks) and the subordinated lenders on the other, the agreements of the latter should be enforced according to their terms in distributing the assets of Weis. As between Weis and the subordinated lenders, the latter are entitled to rescind if fraud is proved; the trustee recognizes this. If the subordinated lenders prove fraud, their claims should be paid before anything is distributed to the stockholders of Weis. But the customer and other general creditors of Weis should be paid before anything is paid to the subordinated lenders.

Every customer and general creditor of Weis knew, or is presumed to have known, that the broker-dealer business of Weis was regulated by federal law and that as part of such regulation the net capital rule was enforced. The subordinated lenders, by their agreements, enabled Weis to comply with the net capital rule and thus to continue in business. The customer and general creditors of Weis should therefore have priority. Under the circumstances, actual reliance is not required to be shown. If the reliance doctrine must be satified as a point of dogma, it should be presumed as a matter of law.

The bank assessment cases seem analogous. Before 1959 (for all practical purposes, before 1933), for many years shareholders of any national bank were by statute personally liable for "all contracts, debts, and engagements" of the bank, to the extent of the par value of their shares; this liability was enforced by assessment. 12 U.S.C. §§ 63, 64.

Cases arose where shareholders defended against an assessment on the ground that their shares were sold by fraud of the bank to them and, since fraud gave them a right of rescission, they were not really to be considered as shareholders. No such defense was allowed because the statutory liability was for the protection of depositors of the bank. It was never suggested that actual reliance on the share ownership or the statutory liability had to be shown.

Such a case was *Scott* v. *Deweese,* 181 U.S. 202, 21 S. Ct. 585, 45 L. Ed. 822 (1901) where (at 213, 21 S. Ct. at 589) it was said:

> "The present suit is primarily in the interest of creditors of the bank. It is based upon a statute designed not only for their protection but to give confidence to all dealing with national banks in respect of their contracts, debts and engagements, as well as to stockholders generally. If the subscriber became a shareholder in consequence of frauds practised upon him by others, whether they be officers of the bank or officers of the Government, he must look to them for such redress as the law authorizes, and is estopped, as against creditors, to deny that he is a shareholder, within the meaning of § 5151, if at the time the rights of creditors accrued he occupied and was accorded the rights appertaining to that position."

A more recent and similar case is *Oppenheimer* v. *Harriman Bank,* 301 U.S. 206, 57 S. Ct. 719, 81 L. Ed. 1042 (1937). Both sides appear to rely on this decision but in my view it supports the position of the trustee. Oppenheimer bought his stock in 1930. The bank closed in 1933 after which Oppenheimer sued for rescission for fraud and eventually secured a money judgment for the amount he had paid for the shares. The Court of Appeals, however, ordered that the judgment be paid only "after payment in full of all who were creditors when the bank became insolvent". This deferment of the judgment was reversed by the Supreme Court which ruled that the judgment was entitled to parity with other unsecured creditors. This ruling was made, however, *because Oppenheimer had already paid the statutory assessment against him.* The significance for the case at bar is the repetition by the Supreme Court of the settled rule that fraud and the ability to rescind are of no avail to defeat protections by statute for a class of creditors. The Supreme Court, citing *Scott* v. *Deweese,* above, with approval, said (301 U.S. at 214, 57 S. Ct. at 724):

> "Plaintiff appeared by the bank's records to be a stockholder and, as against creditors for whose benefit the statutory liability was created, was estopped from denying that status. Recognizing that the bank's fraud and his rescission availed nothing against the comptroller's assessment, plaintiff paid the amount laid against him."

Nothing whatever was said about reliance by creditors on the share ownership or statutory liability.

An even closer analogy is found in an old New York case, *Hurd* v. *Kelly*, 78 N.Y. 588 (1879). A bank was in poor condition. To induce and enable the bank to continue in business Kelly gave the bank a bond, under circumstances strikingly similar to those here. As described in the opinion (at 595):

> "It appears that when the bond was given the assets of the bank had become impaired to an amount as great or greater than the amount of the bond. The bond was executed for the purpose of being exhibited to the bank department as an asset so that the bank might pass the examination and inspection of the department and be enabled to continue its business."

Later the bank failed and a receiver was appointed who sued on the bond. Kelly defended by asserting that he was induced by fraud to sign the bond. This was unanimously held to be no defense, the Court saying (at 596, 597):

> "The intention of the parties was to provide a security in the nature of a guarantee fund of $100,000, to enable the bank to continue its business. It is not claimed that the transaction was *ultra vires*, and if it was, that objection cannot prevail as against the claims of depositors who are represented by the receiver and who is seeking to collect the bond as an asset of the bank, for distribution among those for whose protection it was given. . . .
>
> "The defense that there was a fraudulent concealment by the persons who solicited the defendant to sign the bond, of the true condition of the bank, was, under the circumstances of this case, no answer to the action. It appears from the defendant's answer that he was informed, when he executed the bond, that it was to be used in reference to the relations of the bank to the banking department 'so that a better showing of the apparent assets of the bank would appear.' The defendant was thus apprised that this bond was to be used to give credit to the bank, with the bank department and with the public, so that it should be enabled to continue its business. The fact communicated to him was notice that the bank was in a precarious condition. He knew that if the bond was treated as an asset and the bank thereby allowed to continue its business, new obligations to depositors would be entered into on the faith of the solvency of the institution. Under such circumstances it would be gross injustice to permit the defendant, after having aided the bank to procure credit with the community, to avoid, as against depositors and creditors, the payment of his bond on the allegation that the exact condition of the bank was not disclosed to him, or that it was much worse than was represented. The dealings between him and the officials of the bank, at whose request he signed the bond, ought not, in justice, to be allowed to affect the security given by him for the protection of those dealing with the bank and who must be presumed to have relied thereon in their dealings."

It may be noted that the receiver was not required to show that any depositor in fact knew of Kelly's bond or relied in any way on it. To the contrary, the depositors "must be presumed to have relied thereon in their dealings".

9

[3] Separate consideration should perhaps be given to an additional argument made by the Weis Employees' Profit-Sharing Plan and Trust ("Trust"), one of the subordinated lenders. The Trust argues that its claim should not be subordinated because it falls in, or close to, the category of "wages" given a priority status by Section 64(a)(2) of the Bankruptcy Act (11 U.S.C. § 104(a)(2)). The term "wages" in this section has not been liberally construed but has been

limited to "money directly due [employees] in back wages." *United States* v. *Embassy Restaurant*, 359 U.S. 29, 32, 79 S. Ct. 554, 556, 3 L. Ed. 2d 601 (1959). Contracts in which an employees' trust loans money to the employer at higher than normal interest rates in return for its agreement to subordinate its claim to that of all other creditors scarcely falls within the classic pattern of "back wages".

The order appealed from is reversed and the matter is remanded to the Bankruptcy Judge for further proceedings consistent with this opinion.

SO ORDERED.

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

In the Matter
—of—
WEIS SECURITIES, INC.,
Debtor.

Sol Kittay,
Plaintiff,
v.

Edward Redington, Trustee,
Defendant.

Claims of George D. Aldrich, *et al.*, Subordinated Lenders.

73 Civ. 2332
Memorandum Opinion

ROY BABITT, *Bankruptcy Judge:*

This dispute between the trustee of the debtor (Weis Securities) and subordinated lenders to the debtor arises out of the debtor's financial demise and its subsequent liquidation under the Securities Investors Protection Act of 1970, 15 U.S.C. §§ 78aaa *et. seq.* (1970 ed.) (SIPA). Proceeding on the assumption that there is no real dispute as to what he perceives to be the controlling and material facts, the trustee has moved for summary judgment, Rule 56, F.R. Civ. P., in his favor, thereby leaving these admitted lenders in the subordinated position, a status for which they contracted.[1]

1. Whether Bankruptcy Rule 756, 411 U.S. 1084, making Rule 56, F.R. Civ. P., applicable, or the latter controls, is not material. Either provides the procedural linchpin for setting the stage for the unfolding of this controversy.

What is central to this case is the effort by the subordinated lenders to retrace the chronology during which they acquired their inferior financial position, come to a different arrangement in this second try and thereby improve their legal position to share in the distribution of the debtor's assets within the scheme of the SIPA. Not surprisingly, the trustee vigorously resists. In short, the subordinated lenders seek rescission of their agreements.

The material facts, at least the historical ones, are not in dispute.

During the period between June 28th, 1967 and May 7, 1973, the subordinated lenders, individually, entered into agreements with the debtor under which loans of cash and/or securities were made to the latter for unrestricted use in its business as a broker-dealer. Each agreement contained express, unequivocal and unambiguous provisions to the effect that in the event of liquidation, the subordinated lender agreed to subordinate his claim for property loaned to the claims of all the other creditors of the debtor and to waive any right to participate in the debtor's assets until the claims of all other creditors were satisfied. Further, each subordinated lender agreed not to permit the withdrawal of his property without the consent of the debtor and the New York Stock Exchange (the Exchange) at any time the debtor was in financial difficulty, including the difficulty in complying with the so-called "Net Capital Rule" under Exchange Rule 325. 17 C.F.R. § 240.15.[2]

The subordination agreements also permitted the broker to freely lend or hypothecate securities loaned without the

2. Some of the subordinated lenders claim to have been customers induced by fraudulent misrepresentations into entering subordination agreements on their cash and stocks held, assertedly in trust, by the debtor.

consent of the particular subordinated lender. Almost all of the securities loaned under the subordination agreement were hypothecated to bank as security for loans prior to the commencement of these liquidation proceedings.

On May 24, 1973, Weis' liquidation was begun in keeping with Section 5(b)(1) of the SIPA, 15 U.S.C. § 78eee(b)(1) (1970 ed.), for the appointment of a trustee to liquidate the debtor's business.

In a complaint for injunctive relief filed on the same day, the Securities and Exchange Commission (S.E.C.) alleged, *inter alia,* that certain of the debtor's financial statements were false and misleading, in violation of the provisions of the Securities Exchange Act of 1934, 15 U.S.C. § 78; (b) and Rule X-10 B-5 promulgated thereunder by the S.E.C. The debtor did not contest the issuance of the injunction.

On or about July 16th, 1974, the subordinated lenders instituted various proceedings against the trustee, the legal effect of all of which would be rescission of the subordination agreements.[3] In their application, the subordinated lenders allege substantially the same facts as those contained in the S.E.C. complaint, *i.e.,* false and misleading financial statements made by the debtor to the subordinated lenders to induce the signing of the subordination agreement in violation of the anti-fraud provisions contained in the Securities Exchange Act of 1934 and Rule 10-b 5.

The trustee, insisting that there are no genuine issues of material fact in dispute, invokes Rule 56 of the Federal Rules of Civil Procedure via Bankruptcy Rule 756, see

3. Some filed complaints seeking to reclaim property, thereby following the adversary proceeding route prescribed by Part VII of the Bankruptcy Rules, 411 U.S. 1068, *et seq.*

footnote 1, *supra,* and seeks judgment, the essence of which would leave the subordinated lenders exactly where their agreements placed them. The trustee's position is that even conceding the truth of what the subordinated lenders urge, they are estopped, as a matter of law, to rescind because of the reliance placed on the subordinations by other creditors who extended credit.

There is case law in support of both arguments, and both come with not unrespectable title deeds. But the controlling case decided in this circuit is *In the Matter of Credit Industrial Corporation,* 366 F. 2d 402 (2d Cir. 1966) where the court held that given a lawful and valid subordination agreement, the bankruptcy court is without equitable power to realign the contractual priorities established by the parties in their contract. 366 F. 2d at 409.

This result is not mandated, however, where the subordination agreement is unlawful, *e.g.,* induced by fraudulent misrepresentation, and therefore invalid. The court explained that

> "When a junior creditor establishes that the subordination agreement is unlawful, it *may* be reasonable and necessary, if equity is to be done, to require a senior creditor to prove that he relied on the subordination agreement, without actual or constructive knowledge of any infirmity in the agreement, in advancing funds to the bankrupt as a condition to receiving priority in the distribution of the bankrupt's estate." [emphasis added]

To this court, applying equitable principles, the law seems to be that should reliance be established, estoppel would bar rescission of the subordination agreement. But the establishment of reliance is surely a factual issue en route to application of legal estoppel. So much seems to be the

import of the language quoted above that "it may be reasonable and necessary" to show reliance.

The trustee insists that proof of reliance would be extraneous in the stock brokerage world where members are subject to the net capital rule. The underlying premise of financial regulation in the securities industry is that the public is entitled to deal with a stockbroker without concern for its financial stability. The Securities and Exchange Commission imposes and monitors compliance with rules concerning financial responsibility for the express benefit of the investing public and confidence in the securities world. It is inevitable that investors will rely on this regulatory scheme and the mere existence of a net capital rule alone should be sufficient proof of justified investor reliance upon the probity of dealing in securities.

The subordinated lenders contend that reliance upon the subordination agreement is not to be assumed. There is no evidence that most of Weis' creditors were aware of the subordination agreements or of the net capital rule. To the extent that customers did rely at all, it may be assumed that such reliance was on the protection provided by the federal laws regulating the industry. Indeed, if anything, the SIPA offered greater security in dealings between customers and the debtor-broker.

The net capital rule insures liquidity against current customer demands, not security against broker-dealer insolvency. See *Study of Unsafe and Unsound Practices,* CCH Fed. Sec. L. Rep. Special Studies 74, 801 at 65, 521. The very purpose behind the SIPA was to provide the kind of protection against broker-dealer insolvency which the net capital rule was unable to achieve. Finally, the subordinated lenders contend that it is probable that institutional investors and other large creditors of the debtor were misled

into extending credit on the basis of the very same fraudulent financial statements overstating Weis' net worth that misled these litigants into signing the subordination agreements. But the trustee has no right to assert estoppel. Those dealing with the debtor relied primarily on the false financial statements, not the security provided by the net capital rule.

It seems to this court that reliance must be shown and that summary judgment is not appropriate.

> ". .. summary judgment is a drastic device to be applied only when there are no material factual issues to be tried. In making that determination, the court 'must resolve all ambiguities and draw all reasonable inferences in favor of the party against whom summary judgment is sought . . . with the burden on the moving party to demonstrate the absence of any material factual issue genuinely in dispute'. *Heyman* v. *Commerce and Industry Insurance Co.*, 524 F. 2d 1317, 1320 (2d Cir. 1975); *Judge* v. *City of Buffalo*, 524 F. 2d 1321 2d Cir. 1975)". *Gladstone* v. *Fireman's Fund Insurance Co.*, —— F. 2d —— (2d Cir. May 17, 1976; Docket No. 75-7435).

The issue of reliance is a material one essential to determining whether the court will impose promissory estoppel on the subordinated lenders. In light of the issue raised as to whether there was, in fact, reliance, summary judgment should not preclude a showing; resolution of this factual issue is necessary.

The trustee presses another ground to support summary judgment in his favor. He claims that the subordination agreement was made not only between his adversaries here and the debtor, but also between the former and the Exchange. Thus, the trustee goes on, the Exchange has separate contract rights in the subordination agreements independent of those possessed by the debtor's trustee. But any

rights the Exchange might have are not affected by the debtor's alleged misrepresentations. *Insurance Co. of North America* v. *Brehm*, 257 Ore. 385, 393-394, 478 P. 2d 387, 391 (1971); *Peoples Trust Co.* v. *O'Neil*, 273 N.Y. 312, 316, 7 N.E. 2d 244, 246 (1937). The debtor's creditors and customers are clearly the third party beneficiaries of the agreements with the Exchange and could themselves sue the subordinated lenders for specific performance of open promises. *Pond* v. *New Rochelle Water Co.*, 183 N.Y. 330, 76 N.E. 211 (1906). Accordingly, the trustee could sue on the subordinated lenders' promises by his title to causes of action under Section 70a of the Act, 11 U.S.C. § 110a. The subordinated lenders vigorously and correctly disagree with the trustee's stand on this. There is no evidence of any contractual agreement between the subordinated lenders and the Exchange. The New York Stock Exchange was not a party to the Senior Subordinated Note Agreement which the lenders and the debtor executed on September 29; indeed, the Exchange was in no way involved in the dealings between the lenders and the debtor. Nor did the lenders enter into separate agreement with the Exchange to subordinate their rights. The fact that the transactions between the debtor and the lenders required Exchange approval does not make the Exchange a party to the transaction. Absent evidence of a subordination agreement with the Exchange, the trustee's theory falls.

The court therefore denies trustee's motion for summary judgment as an evidentiary hearing is needed in respect of the following material issues of fact: did the general creditors rely upon the subordination agreement or the net capital rule when they invested in or extended credit to the debtor; is there conclusive proof that the subordinated lenders entered into a separate subordination agreement with the New York Stock Exchange. If either of the above

two questions results in an affirmative finding the trustee will be entitled to judgment. If reliance is proven, the subordinated lenders will be estopped from rescinding the agreement for fraud. *In the Matter of Credit Industrial Corporation, supra,* at 409. If an independent contract between claimant and the New York Stock Exchange is substantiated, that contract will remain in force regardless of any fraud perpetrated by Weis. *Insurance Co. of North America* v. *Brehm, supra,* at 392, 390.

If neither of the above questions is answered by an affirmative finding, it will become necessary to determine whether the debtor fraudulently misrepresented financial information of sufficient materiality to support rescission of the subordination agreement. In short, the court concludes that there is a two step inquiry which must be had and upon which findings must be made following trial. The second is reached only if the first is found in favor of the lenders.

Accordingly, summary judgment is refused by reason of the existence of material facts as to which the court is unable to make findings for want of probative evidence. Trial will be had on these issues following recourse to the discovery procedures carried in the Federal Rules of Civil Procedure and the Bankruptcy Rules incorporating the former. Upon conclusion of all discovery, the court will fix a trial date after a pre-trial conference with counsel to be arranged on five days notice. Submit order.

DATED: New York, New York.

July 15, 1976

ROY BABITT,
Bankruptcy Judge.

FEDERAL STATUTES

Securities Act of 1933*

15 U.S.C. § 77p

Additional remedies

The rights and remedies provided by this subchapter shall be in addition to any and all other rights and remedies that may exist at law or in equity.

15 U.S.C. § 77r

State control of securities

Nothing in this subchapter shall affect the jurisdiction of the securities commission (or any agency or office performing like functions) of any State or Territory of the United States, or the District of Columbia, over any security or any person.

Securities Exchange Act of 1934

15 U.S.C. § 78f

Registration of national securities exchanges

(a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents, below specified:

(1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or regulation) to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of this chapter, and any amendment thereto and any rule or regulation made or to be made thereunder;

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* Provisions of the Securities Acts are set forth as they were in effect prior to the Securities Acts Amendments of 1975, Pub L. No. 94-29, 89 Stat. 97 (June 4, 1975).

(2) Such data as to its organization, rules or procedure, and membership, and such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors;

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange"; and

(4) An agreement to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption.

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the willfull violation of any provisions of this chapter or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(c) Nothing in this chapter shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this chapter and the rules and regulations thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this chapter and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(e) Within thirty days after the filing of the application, the Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying registration as a national securities exchange, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission, and upon such terms as the Commission may deem necessary for the protection of investors, withdraw its registration.

Securities Investor Protection Act of 1970

15 U.S.C. § 78bbb

Application of securities exchange act of 1934

Except as otherwise provided in this Act, the provisions of the Securities Exchange Act of 1934 (15 U.S.C., sec. 78a and fol.; hereinafter referred to as the "1934 Act") apply as if this Act constituted an amendment to, and was included as a section of, such Act.

15 U.S.C. § 78ccc

Securities investor protection corporation

(a) Creation.—There is hereby established a body corporate to be known as "Securities Investor Protection Corporation" (hereafter in this Act referred to as "SIPC"). SIPC shall be a nonprofit corporation and shall have succession until dissolved by act of the Congress. SIPC shall—

(1) not be an agency or establishment of the United States Government;

(2) be a membership corporation the members of which shall be—

(A) All persons registered as brokers or dealers under section 15(b) of the 1934 Act, and

(B) all persons who are members of a national securities exchange,

* * * *

15 U.S.C. § 78ddd

SIPC Fund

(a) In General.—

(1) Establishment of fund.—SIPC shall establish a "SIPC Fund" (hereinafter in this Act referred to as the "fund"). All amounts received by SIPC (other than amounts paid directly to any lender pursuant to any pledge securing a borrowing by SIPC) shall be deposited in the fund, and all expenditures made by SIPC shall be made out of the fund.

* * * *

(c) Assessments.—

(1) Initial assessments.—Each member of SIPC shall pay to SIPC, or the collection agent for SIPC specified in section 9(a), on or before the one hundred and twentieth day following the date of enactment of this Act, an assessment equal to one-eighth of 1 per centum of the gross revenues from the securities business of such member during the calendar year 1969, or if the Commission shall determine that, for purposes of assessment pursuant to this paragraph, a lesser percentage of gross revenues from the securities business is appropriate for any class or classes of members (taking into account relevant factors, including but not limited to types of business done and nature of securities sold), such lesser percentages as the Commission, by rule or regulation, shall establish for such class or classes, but in no even less than one-sixteenth of 1 per centum for any such class. In no event shall any assessment upon a member pursuant to this paragraph be less than $150.

(2) General assessment authority.—SIPC shall, by bylaw or rule, impose upon its members such assessments as, after consultation with self-regulatory organizations, SIPC may deem necessary and appropriate to establish and maintain the fund and to repay any borrowings by SIPC. Any assessments so made shall be in conformity with contractual obligations made by SIPC in connection with any borrowing incurred by SIPC. Subject to paragraph (3) and subsection (d)(1)(A), any such assessment upon the members, or any one or more classes thereof, may, in whole or in part, be based upon or measured by (A) the amount of their gross revenues from the securities business, or (B) all or any of the following factors: the amount or composition of their gross revenues from the securities business, the number or dollar volume of transactions effected by them, the number of customer accounts maintained by them or the amounts of cash and securities in such accounts, their net capital, the nature of their activities (whether in the securities business or otherwise) and the consequent risks, or other relevant factors.

* * * *

(g) SEC Loans to SIPC.—In the event that the fund is or may reasonably appear to be insufficient for the purposes of this Act, the Commission is authorized to make loans to SIPC. At the time of application for, and as a condition to, any such loan, SIPC shall file with the Commission a statement with repect to the anticipated use of the proceeds of the loan. If the Commission determines that such loan is necessary for the protection of customers of brokers or dealers and the maintenance of confidence in the United States securities markets and that SIPC has submitted a plan which provides as reasonable an assurance of prompt repayment as may be feasible under the circumstances, then the Commission shall so certify to the Secretary of the Treasury, and issue notes or other obligations to the Secretary of the Treasury pursuant to subsection (h) . . .

(h) SEC Notes Issued to Treasury.—To enable the Commission to make loans under subsection (g), the Commission is authorized to issue to the Secretary of the Treasury notes or other obligations in an aggregate amount of not to exceed $1,000,000,000, in such forms and denominations, bearing such maturities, and subject to such terms and conditions, as may be prescribed by the Secretary of the Treasury. Such notes or other obligations shall bear interest at a rate determined by the Secretary of the Treasury, taking into consideration the current average market yield on outstanding marketable obligations of the United States of comparable maturities during the month preceding the issuance of the notes or other obligations. The Secretary of the Treasury may reduce the interest rate if he determines such reduction to be in the national interest. The Secretary of the Treasury is authorized and directed to purchase any notes and other obligations issued hereunder and for that purpose he is authorized to use as a public debt transaction the proceeds from the sale of any securities issued under the Second Liberty Bond Act, as amended, and the purposes for which securities may be issued under that Act, as amended, are extended to include any purchase of such notes and obligations. The Secretary of the Treasury may at any time sell any of the notes or other obligations acquired by him under this subsection. All redemptions, purchases, and sales by the Secretary of the Treasury of such notes or other obligations shall be treated as public debt transactions of the United States.

15 U.S.C. § 78fff

Liquidation proceedings

(a) General Purposes of Liquidation Proceeding.—The purposes of any proceeding in which a trustee has been appointed under section 5(b) (3) (hereafter in this section referred to as a "liquidation proceeding") shall be:

(1) as promptly as possible after such appointment and in accordance with the provisions of this sections—

(A) to return specifically identifiable property to the customers of the debtor entitled thereto;

(B) to distribute the single and separate fund, and (in advance thereof or concurrently therewith) pay to customers moneys advanced by SIPC, as provided in subsection (f);

(2) to operate the business of the debtor in order to complete open contractual commitments of the debtor pursuant to subsection (d);

(3) to enforce rights of subrogation as provided in this Act; and

(4) to liquidate the business of the debtor.

* * * *

(c) Application of Bankruptcy Act.—

* * * *

(2) Special Provisions.—The following subparagraphs of this paragraph shall apply to a liquidation proceeding in lieu of section 60e of the Bankruptcy Act:

(A) Definitions.—Except as otherwise expressly provided in this section, for purposes of this section and the application of the Bankruptcy Act to a liquidation proceeding—

(i) "property" includes cash and securities, whether or not negotiable and all property of a similar character;

(ii) "customers" of a debtor means persons (including persons with whom the debtor deals as principal or agent) who have claims on account of securities received, acquired, or held by the debtor from or for the account of such

persons (I) for safekeeping, or (II) with a view to sale, or (III) to cover consummated sales, or (IV) pursuant to purchases, or (V) as collateral security, or (VI) by way of loans of securities by such persons to the debtor, and shall include persons who have claims against the debtor arising out of sales or conversions of such securities, and shall include any person who has deposited cash with the debtor for the purpose of purchasing securities, but shall not include any person to the extent that such person has a claim for property which by contract, agreement, or understanding, or by operation of law, is part of the capital of the debtor or is subordinated to the claims of creditors of the debtor;

(iii) "cash customer" means, with respect to any securities or cash, customers entitled to immediate possession of such securities or cash without the payment of any sum to the debtor, and for purposes of this clause, the same person may be a cash customer with reference to certain securities or cash and not a cash customer with reference to other securities or cash;

* * * *

(f) SIPC Advances to Trustee.—

(1) Advances for customers' claims.—In order to provide for prompt payment and satisfaction of the net equities of customers of debtor, SIPC shall advance to the trustee such moneys as may be required to pay or otherwise satisfy claims in full of each customer, but not to exceed $50,000 for such customer; except that—

(A) insofar as all or any portion of the net equity of a customer is a claim for cash, as distinct from securities, the amount advanced by reason of such claim to cash shall not exceed $20,000;

(B) a customer who holds accounts with the debtor in separate capacities shall be deemed to be a different customer in each capacity;

(C) no such advance shall be made by SIPC to the trustee to pay or otherwise satisfy, directly or indirectly, any claims of any customer who is a general partner, officer, or director of the debtor, the beneficial owner of 5 per centum or more of any class of equity security of the debtor (other than a nonconvertible stock having fixed preferential dividend and liquidation rights) or limited partner with a participation of 5 per centum or more in the net assets or net profits of the debtor; and

(D) no such advance shall be made by SIPC to the trustee to pay or otherwise satisfy claims of any customer who is a broker or dealer or bank other than to the extent that it shall be established to the satisfaction of the trustee, from the books and records of the debtor or from the books and records of a broker or dealer or bank or otherwise, that claims of such broker or dealer or bank against the debtor arise out of transactions for customers of such broker or dealer or bank, in which event, each such customer of such broker or dealer or bank shall be deemed a separate customer of the debtor.

To the extent that moneys are advanced by SIPC to the trustee to pay the claims of customers, SIPC shall be subrogated to the claims of such customers with the rights and priorities provided in this section.

* * * *

15 U.S.C. § 78iii

Functions of self-regulatory organizations.

(a) Colletcing Agent.—Each self-regulatory organization shall act as collection agent for SIPC to collect the assessments payable by all members of SIPC for

whom such self-regulatory organization is the examining authority, and members of SIPC who are not members of any self-regulatory organization shall make payment direct to SIPC. An examining authority shall be obligated to remit to SIPC assessments made under section 4 only to the extent that payments of such assessments are received by such examining authority.

RULES OF THE NEW YORK STOCK EXCHANGE

Rule 325.

"(a) No member or member organization doing any business with others than members or member organizations or doing a general business with the public, except a member or member organization subject to supervision by State or Federal banking authorities, shall permit, in the ordinary course of business as a broker, his or its Aggregate Indebtedness to exceed 1500 per centum of his or its Net Capital, which Net Capital shall be not less than $100,000 in the case of a member organization which carries any accounts for customers. . . .

"(b) For the purpose of this rule—

"(1) The term 'proprietary accounts' shall include capital accounts of partners or sole proprietor, investment and trading accounts, participations in joint accounts, accounts of partners which are covered by agreements, approved by the Exchange, providing for the inclusion of equities therein as partnership property and borrowings covered by subordination agreements approved by the Exchange;

"(2) the term 'Aggregate Indebtedness' shall include the total money liabilities of the member or member organization in all accounts other than customers' and brokers' accounts for commodity future contracts; plus equities in customers' and brokers' accounts for commodity future contracts; plus the market value of securities borrowed (other than for delivery against

customers' sales) for which no equivalent value is paid or credited, exclusive of the following:

"(A) money borrowed (adequately collateralized) on securities, spot commodities or other assets owned by the member, member firm or general partner thereof, or a member corporation and on those subordinated to general creditors;

"(B) money payable against securities loaned which are owned by the member, member firm or general partner thereof, or a member corporation and those subordinated to general creditors;

"(C) money payable against securities failed to receive in connection with transactions for the account of the member, member firm or general partner thereof, or a member corporation and for accounts subordinated to general creditors;

"(D) money borrowings adequately collateralized by securities exempted from registration under the Securities and Exchange Act of 1934, otherwise than by action of the Securities and Exchange Commission;

"(E) liabiilties subordinated to general creditors pursuant to a separate agreement approved by the Exchange;

"(3) The term 'Net Worth' shall be the excess of total assets over total liabilities, after provision for current dividends declared and unpaid by a member corporation (except that credit balances and equities in 'proprietary accounts' shall not be considered as liabilities) with securities, spot commodities, commodity future contracts in 'proprietary accounts' and all other assets marked to market or fair value. A loss, at market, in an individual contractual commitment shall be deducted in determining Net Worth and a profit shall not be included. (See (c)(10) 'Special Provisions' below.)

"(4) the term 'Net Capital' shall be Net Worth, less the following:

Debit Items

"(A) Amounts included in Net Worth for:

"(i) Memberships, furniture and fixtures, real estate and other fixed assets;

"(ii) the value of securities which have no ready market or the sale of which is inhibited by a statutory, regulatory or contractual provision;

". . ."

Rule 325.20

"*Subordinated borrowings by member organizations evidenced by non-transferable instruments.*—All subordinated borrowings by a member organization evidenced by instruments which are not transferable without the prior consent of the Exchange, where the proceeds, whether of cash or securities, or both, are to be considered in the computation of Net Capital under Rule 325, must receive prior approval of the Exchange. Such borrowings may be arranged with anyone acceptable to the Board of Governors and are subject to the following provisions:

"(1) Subordinated borrowings of cash

"(A) The lender may be paid interest not to exceed the rate set from time to time by the Exchange.

"(B) If the lender is

"(i) a member of the family of one of the borrowing organization's general partners or holders of voting stock, or of a deceased general partner or holder of voting stock;

"(ii) an estate of or trust established by or for one of the borrowing organization's general partners or holders of voting stock;

"(iii) one of the borrowing organization's employees or the employee pension, retirement or profit-sharing plan of the borrowing organization; or

"(iv) a limited partner or holder of non-voting stock of the borrowing organization he may also share in organization profits to a reasonable extent.

"(2) Subordinated borrowings of securities

"(A) If the lender is a person listed in (1)(B) above, he may be paid interest not to exceed the rate set from time to time by the Exchange. He may also share in organization profits to a reasonable extent.

"(B) If the lender is anyone other than those listed in (1)(B) above

"(i) the number of such borrowings by a member organization shall be reasonable in relation to the size of the organization, and the total dollar amount of such borrowings shall not constitute more than 25% of the total capital of the borrowing organization.

"(ii) compensation for the loan or subordination of the account shall not exceed the rate set from time to time by the Exchange.

"(3) Application of the borrowing member organization shall be filed with the Exchange together with application signed by the lender, in form prescribed by the Exchange, which shall contain the following:

"(A) name of the lender; (identify the relationship of the lender to the organization or one of its general partners or holders of voting stock);

"(B) signed copy of the subordination agreement in form prescribed by the Exchange;

"(C) opinion of counsel to the borrowing organization stating that the subordination agreement is binding and enforceable in accordance with its terms upon the lender and his creditors;

"(D) check of the applying member organization for $100 covering Exchange fee for consideration of the application. While the fee is payable at the time of posting, a member organization may request that the charge be placed on the regular quarterly statement from the Exchange;

"(5) Borrowings must be made pursuant to printed standard forms prescribed as permitted by the Exchange, to increase and in no event to decrease the permanence of the capital funds. These forms provide, among other things:

"(A) That cash may be contributed to a member organization by means of a cash subordinated loan agreement or a subordinated debenture, with a maturity date at least one year from the date of the subordinated loan or debenture, and with acceleration provisions, if any, which may be exercised on not less than six months' written notice given no sooner than six months from the date of the subordinated loan or debenture, provided that if, after giving effect to payment at maturity date or any accelerated maturity date, the Aggregate Indebtedness of the member organization would exceed 1200 per centum of its Net Capital, or its Net Capital would fail to equal or exceed the minimum dollar amount required by Rule 325(a), the obligation of the member organization to repay the subordinated loan or debenture would be postponed until, after giving effect to such payment, the Aggregate Indebtedness of the member organization would not exceed 1200 per centum of its Net Capital or its Net Capital would equal or exceed the minimum dollar amount required by Rule 325(a). The amount of a subordinated loan or debenture may be decreased or the principal may be paid off with the prior written approval of the Exchange. Each member organization shall promptly notify the Exchange of the receipt of any notice of accelerated maturity of any subordinated loan or debenture or if the payment of any subordinated debt is not made because, after giving effect to such payment, the Aggregate Indebtedness of the member organization would exceed 1200 per centum of its Net Capital or its Net Capital would fail to equal or exceed the minimum dollar amount required by Rule 325(a).

"(B) That securities which are fully paid for may be contributed to a member organization as collateral for a secured demand note, pursuant to a secured demand note collateral agreement which provides that if at any time the capital requirements value of the collateral is less than the then unpaid balance of the secured demand note the member organization shall notify the lender. Following such notification, the lender may (i) with the prior consent of the Exchange reduce the principal amount of the secured demand note by not more than 15%, provided the member organization clearly establishes that the Aggregate Indebtedness of the member organization would not exceed 1000% of its Net Capital after giving effect to such reduction, and further provided that in the event of such reduction the right of the lender to withdraw collateral shall be suspended, or (ii) contribute additional collateral sufficient to bring the value for Net Capital purposes of the collateral up to the then unpaid balance of the secured note. Unless the unpaid principal amount of the note is reduced or such additional collateral is so pledged, the collateral securing the note shall be sold on the business day next succeeding the giving of such notice. Wtihout the prior written approval of the Exchange, the secured demand note may not be withdrawn prior to the withdrawal date fixed in the collateral agreement, which date must be at least one year but not more than ten years from the date of the collateral agreement, provided, however, that the contributor may accelerate the withdrawal date by giving not less than six months written notice to the organization and to the Exchange delivered no sooner than six months from the date of the collateral agreement. At any time, if after giving effect to a proposed withdrawal, the Aggregate Indebtedness of the member organization would exceed 1200 per centum of its Net Capital or its Net Capital would fail to meet the minimum dollar amount required by Rule 325(a), the member organization's obligation to return the secured demand note and the collateral shall be suspended. Each member organization shall promptly notify the Exchange of the receipt of any notice of accelerated maturity of any secured demand note or if any withdrawal of subordinated debt is not made because, after giving effect to such withdrawal, the Aggregate Indebtedness of the member

organization would exceed 1200 per centum of its Net Capital or its Net Capital would fail to meet the minimum dollar amount required by Rule 325(a).

"(C) That with the prior approval of the Exchange cash or securities (including equities in margin accounts) may be contributed to a member organization by its members, allied members, limited partners or holders of non-voting common stock as temporary capital for the purpose of adding to its Net Capital in connection with unusual underwritings. Such temporary infusions may not be made on more than three occasions in any twelve month period. If in the form of cash, the temporary subordinated loan would be evidenced by a temporary cash subordination agreement or a temporary subordinated debenture, and if in the form of securities by a secured demand note and a temporary secured demand note collateral agreement. The debenture or the collateral agreement shall bear a maturity date of 45 days from the date thereof and may not be repaid at any time, if after giving effect to such repayment, the Aggregate Indebtedness of the member organization would exceed 1000 per centum of its Net Capital or its Net Capital should be less than the minimum dollar amount required by Rule 325(a). Neither agreement would contain any provisions for acceleration of the maturity date and a contributor pursuant to a temporary secured demand note collateral agreement would not have an option to reduce the principal amount of an undercollateralized note, but in almost every other respect, the temporary capital agreements would resemble the agreements described in A and B.

"(5) Each member organization which has subordinated debt or equity capital scheduled for withdrawal shall take whatever measures are necessary to replace the capital scheduled for withdrawal or to reduce its capital needs commensurate with the amount of capital remaining after withdrawal. Failure of the member organization to take such measures in a timely manner

will result in corrective action being required by the Exchange under Rule 326.

"(6) A statement of a proposed lender for approval to make a subordinated loan to a member organization is ordinarily not acted upon by the Board of Governors until after notice of the proposal has been posted on the Bulletin Board of the Exchange for a period of two weeks. Such notice is posted upon submission, in proper form, of all required papers in connection with the proposal."

Rule 405. Every member organization is required through a general partner, a principal executive officer or a person or persons designated under the provisions of Rule 342(b)(1) [¶ 2342] to:

(1) Use due diligence to learn the essential facts relative to every customer, every order, every cash or margin account accepted or carried by such organization and every person holding power of attorney over any account accepted or carried by such organization.

Supervision of Accounts

(2) Supervise diligently all accounts handled by registered representatives of the organization.

Approval of Accounts

(3) Specifically approve the opening of an account prior to or promptly after the completion of any transaction for the account of or with a customer, provided, however, that in the case of branch offices, the opening of an account for a customer may be approved by the manager of such branch office but the action of such branch office manager shall within a reasonable time be approved by a general partner, a principal executive officer or a person or persons designated under the provisions of Rule 342(b)(1) [¶ 2342]. The member, general partner, officer or designated person approving the opening of the account shall, prior to giving his ap-

proval, be personally informed as to the essential facts relative to the customer and to the nature of the proposed account and shall indicate his approval in writing on a document which is a part of the permanent records of his office or organization.

Common Sales Accounts

(4) To facilitate the isolated liquidation of securities valued at $1,000 or less registered in the name of an individual who does not have an account, and which are not part of any distribution, a member organization may sell the securities through a common sales account set up for the specific purpose of handling such sales without sending a periodic statement to the customer as required by Rule 409, provided:

a) The customer is identified as the individual in whose name the securities are registered,

b) The securities are received by the member, at or prior to the time of the entry of the order, in the exact amount to be sold in good delivery form,

c) A confirmation is sent to each customer,

d) All proceeds of such sales are paid out on or immediately following settlement date, and

e) The record made in the common sales account includes as to each transaction: customer's name address, name and amount of securities to be sold, date received, date sold, amount per share, total amount credited to the account, total amount of check issued to the customer and the date of disbursement.

ILLINOIS STATUTES

Ill. Rev. Stat. (1977) ch. 121½ § 137.12

Violation. It shall be a violation of the provisions of this Act for any person:

A. To sell any security except in accordance with the provisions of this Act;

B. To deliver to a purchaser any security required to be registered under Section 5, Section 6 or Section 7 hereof unless accompanied or preceded by a prospectus that meets the requirements of the pertinent subsection of Section 5 or of Section 6 or of Section 7;

C. To act as a dealer, salesman or investment adviser unless registered as such, where such registration is required, under the provisions of this Act;

D. To fail to file with the Secretary of State any application, report or document required to be filed under the provisions of this Act or any rule or regulation made by the Secretary of State pursuant to this Act or to fail to comply with the terms of any order of the Secretary of State issued pursuant to Section 11 hereof;

E. To make, or cause to be made, (1) in any application, report or document filed under this Act or any rule or regulation made by the Secretary of State pursuant to this Act, any statement which was false or misleading with respect to any material fact or (2) any statement to the effect that a security (other than a security issued by the State of Illinois) has been in any way endorsed or approved by the Secretary of State or the State of Illinois;

F. To engage in any transaction, practice or course of business in connection with the sale or purchase of securities which works or tends to work a fraud or deceit upon the purchaser or seller thereof;

G. To obtain money or property through the sale of securities by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading;

H. To sign or circulate any statement, prospectus, or other paper or document required by any provision of this Act knowing or having reasonable grounds to know any material representation therein contained to be false or untrue;

I. To employ any device, scheme or artifice to defraud in connection with the sale or purchase of any security, directly or indirectly.

J. When acting as an investment adviser, by any means or instrumentality, directly or indirectly:

(1) To employ any device, scheme or artifice to defraud any client or prospective client;

(2) To engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

(3) To engage in any act, practice, or course of business which is fraudulent, deceptive or manipulative. The Secretary of State shall for the purposes of this Paragraph (3) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive or manipulative.
Amended by P.A. 76-1083, § 1, eff. Jan. 1, 1970.

Ill. Rev. Stat. (1977) ch. 121½, § 262

Unlawful practices—Construction with Federal Trade Commission Act.] Unfair methods of competition and unfair or deceptive acts or practices, including but not limited to the use or employment of any deception, fraud, false pretense, false promise, misrepresentation or the concealment, suppression or omission of any material fact, with intent that others rely upon the concealment, suppression or omission of such material fact, or the use or employment of any practice described in Section 2 of the "Uniform Deceptive Trade Practices Act", approved August 5, 1965, in the conduct of any trade or commerce are hereby declared unlawful whether any person has in fact been mislead, deceived or damaged thereby. In construing this section consideration shall be given to the interpretations of the Federal Trade Commission and the federal courts relating to Section 5(a) of the Federal Trade Commission Act.

Amended by P.A. 78-904, § 1, eff. Oct. 1, 1973.

Ill. Rev. Stat. (1971) ch. 121½ § 262

Unlawful practice.] The act, use or employment by any person of any deception, fraud, false pretense, false promise, misrepresentation, or the concealment, suppression, or omission of any material fact with intent that others rely upon such concealment, suppression or omission, in connection with the sale or advertisement of any merchandise, whether or not any person has in fact been misled, deceived or damaged thereby, is declared to be an unlawful practice; provided, however, that nothing herein contained shall apply to the owner or publisher of newspapers, magazines, publications or printed matter wherein such advertisement apepars, or to the owner or operator of a radio or television station which disseminates such advertisement when the owner, publisher or operator has no knowledge of the intent, design or purpose of the advertiser; and provided, further, that nothing herein contained shall apply to any advertisement which is subject to and complies with the rules and regulations of, and the statutes administered by the Federal Trade Commission.

Ammended by P.A. 76—1061, § 1, eff. Aug. 28, 1969.
Added by L. 1965, p. 835.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN the Matter of WEIS SECURITIES, INC., *Debtor.*	73 Civ. 2332 Petition on Behalf of Eva Grossmann

NOW COME THE PEOPLE OF THE STATE OF ILLINOIS ex rel. WILLIAM J. SCOTT, the Attorney General of the State of Illinois, and, in behalf of EVA GROSSMANN, a citizen and resident of the State of Illinois, repectfully petition this Honorable Court as follows:

1. EVA GROSSMANN is a citizen and resident of the State of Illinois. She is a foreign born widow. After having spent the greater part of the war years during the Second World War as a slave laborer in German concentration camps, she came to this country in 1947. From that time on she worked, with the exception of a short intermission, continuously as a fitter for Chas. A. Stevens Co. in Chicago, Illinois, where she is still employed.

2. In 1967, after her husband's death, she was induced by the husband of one of the store's customers, at which she was working, to put all her savings in subordinate debentures of Weis, Voisin, Cannon, Inc. The man who induced her to place her savings in those subordinate debentures was Leo Meiselman, Executive Vice President of Weis, Voisin, Cannon, Inc.

3. In accordance with the aforementioned inducement, a debenture was issued to Mrs. Grossmann by Weis, Voisin and Cannon, in the amount of 15,000.00 on the 28th of June, 1967, denominated as a two year Debenture Bond. A copy of a letter of Weis, Voisin, Cannon, Inc., dated June 29, 1967, as well as a copy of the bond are herewith attached to this Petition as Exhibit A and B, respectively, and made a part hereof. In a letter, dated July 2, 1969, addressed to Mrs. Grossmann, Weis, Voisin, Cannon, Inc. acknowledged receipt from Mrs. Grossmann of a check in the amount of $5,000.00 for Mrs. Grossmann's Debenture Account; a copy of that letter is attached to this Petition as Exhibit C. No Debenture Bond for the amount of $5,000.00 was ever delivered to Mrs. Grossmann.

4. The debenture bonds in the amount of $20,000.00 were automatically renewed by Weis, Voisin, Cannon, Inc. without ever having asked Mrs. Grossmann for her approval. See copy of letter of Weis, Voisin, Cannon, Inc. dated June 18, 1969, herewith attached hereto as Exhibit D.

5. By letter dated April 27, 1973, Weis Securities, Inc. requested Mrs. Grossmann to confirm her account of Subordinated Debentures in the sum of $20,000.00. A copy of that letter is herewith attached to this Petition as Exhibit E.

6. At no time did Weis, Voisin, Cannon, Inc. or any of its representatives inform Mrs. Grossmann of the fact that the debentures issued to her were unsecured and subordinated to the claims of other creditors, nor did Mrs. Grossmann have the educational background or the financial capability or sophistication to understand or grasp the import and significance of a subordinated-unsecured debenture.

7. At no time was any notice or information furnished to Mrs. Grossmann that Weis, Voisin, Cannon, Inc. had transferred its business to Weis Securities. Failure to give such information was in clear violation of the Illinois Bulk Sales Act.

8. The failure of Weis, Voisin, Cannon, Inc. to fully inform and advise Mrs. Grossmann regarding the nature of the securities sold to her was not only in violation of the Illinois Securities Act (Ill. Rev. Stat. 1973, ch. 121-½, sec. 137.12(F), (G), and (I)), and the pertinent provisions of the Federal Securities and Exchange Act but also amounted to gross fraud and the breach of a fiduciary duty owed by the broker to the customer.

9. Weis, Voisin, Cannon, Inc. and Weis Securities, Inc., having committed such fraud and having acted in contravention of the applicable statutes as well as having been guilty of a gross breach of their fiduciary duties, the amount of $20,000.00 paid by Mrs. Grossmann was unlawfully received and held under a constructive trust by Weis, Voisin, Cannon, Inc. and Weis Securities for the benefit of claimant, EVA GROSSMANN.

10. The claim of EVA GROSSMANN in the amount of $20,000.00 was allowed in full by the Trustee as a claim subordinate to the claims of creditors of the Debtor.

WHEREFORE, it is respectfully petitioned that this Court order that the amount of TWENTY THOUSAND DOLLARS ($20,000.00) is held by the Trustee for the liquidation of the business of Weis Securities, Inc., under a con-

structive trust for the benefit of the claimant, EVA GROSSMANN, and that said amount be segregated from the estate in liquidation and paid out in full to claimant, EVA GROSSMANN.

Respectfully submitted,

WILLIAM J. SCOTT,
Attorney General of the
State of Illinois.

By: FRED F. HERZOG,
160 North LaSalle Street,
Suite 900,
Chicago, Illinois 60601,
(793-3500).

FRED F. HERZOG,
First Assistant Attorney General,
160 North LaSalle Street, Suite 800,
Chicago, Illinois 60601 (793-2457),
Of Counsel.

WEIS, VOISIN, CANNON, INC.
ESTABLISHED 1927
MEMBERS NEW YORK AND AMERICAN STOCK EXCHANGES
AND PRINCIPAL COMMODITY EXCHANGES
141 W. JACKSON BOULEVARD • CHICAGO, ILL. 60604
WABASH 2-5100

MAIN OFFICE
111 BROADWAY
NEW YORK, N. Y. 10006
WORTH 4-7300

BRANCH OFFICES
63RD ST. & 2ND AVE., N. Y. C.
CEDARHURST, L. I., N. Y.
CHICAGO, ILLINOIS
NEW HAVEN, CONN.
ENGLEWOOD, N. J.
MAPLEWOOD, N. J.
MIAMI BEACH, FLA.

June 29, 1967

EXHIBIT A

Mrs. Eva Grossman
1050 West Catalpa
Chicago, Illinois 60640

Dear Mrs. Grossman:

We acknowledge receipt of:

Cashier check #099881 drawn on the Chicago Federal Savings and Loan Association payable to Weis, Voisin, Cannon, Inc. in the amount of $7,000.00, and

Cashier check #SO417669 drawn on the Uptown Federal Savings and Loan Association payable to Weis, Voisin, Cannon, Inc. in the amount of $8,000.00.

These funds are to be used to purchase two-year debentures with ninety day notice from our firm, Weis, Voisin, Cannon, Inc.

Thank you for your cooperation, I am,

Respectfully,

WEIS, VOISIN, CANNON, INC.
S/ Leo Meiselman,
Leo Meiselman,
Executive Vice President

LM:mek
Encl.

No. 31 $ 15,000

WEIS, VOISIN, CANNON, INC.

INCORPORATED UNDER THE LAWS OF THE STATE OF DELAWARE

NAME OF REGISTERED OWNER Mrs. Eva Grossmann

WEIS, VOISIN, CANNON, INC., a corporation duly organized and existing under and by virtue of the laws of the State of Delaware, and duly authorized to conduct business in the State of New York (hereinafter called "Corporation") being a member of the New York Stock Exchange, the American Stock Exchange and other principal commodity exchanges, with its principal office at 111 Broadway, New York, N. Y., hereby promises to pay to the registered holder hereof (unless this debenture shall have been duly called for previous redemption and payment) upon presentation hereof on the 1st day of July, 1969, in legal tender of the United States of America, the principal sum of * * * * * * FIFTEEN THOUSAND * * * * * DOLLARS ($ 15,000.00)

Payments of principal as well as interest, are to be made at the Main Office of the Corporation. Interest on the remaining unpaid balance of principal shall become due at the rate of 8 per cent per annum from the date hereof, such interest being payable quarter-annually on the first day of April, July, October and January of each month in each and every such month following the date hereof.

The registered holder by acceptance of this subordinated debenture agrees for himself, his heirs, executors, administrators and assigns that the obligations of the Corporation under this agreement with respect to the payment of principal and interest are and shall be subordinate in right of payment and subject to the prior payment or provision for payment in full of all claims of all other present and future creditors of the Corporation arising out of any matter occurring prior to the Installment Date, and that, in the event of any receivership, insolvency, bankruptcy, assignment for the benefit of creditors, reorganization, whether or not pursuant to bankruptcy laws, liquidation, or any other marshalling of the assets and liabilities of the Corporation, the holder hereof shall not be entitled to participate or share, ratably or otherwise, in the distribution of the assets of the Corporation until all claims of all other present and future creditors of the Corporation arising out of any matter occurring prior to the Installment Date have been fully satisfied, or provision has been made therefor.

This loan and the various installments thereof hereinabove designated in the repayment schedule, may not be paid in whole or in part prior to the respective Installment Dates there indicated without prior notice to the New York Stock Exchange. If the loan, or any installment thereunder is paid in whole or in part on or prior to the respective Installment Dates and if at the time of any such payment the Corporation shall be insolvent, the registered holder agrees irrevocably for himself, his heirs, executors, administrators and assigns (whether or not such registered holder, his heirs, executors, administrators or assigns shall have had any knowledge or notice of such insolvency at the time of any such payment) to repay to the Corporation, its successors and assigns, the sum so paid, for the benefit of all other creditors of the Corporation; provided, however, that any suit for the recovery of any such payment must be commenced within one year of the date of such payment.

The unpaid portion of the obligation of the Corporation hereunder shall forthwith mature, together with interest accrued thereon, in the event of any receivership, insolvency, bankruptcy, assignment for benefit of creditors, reorganization, whether or not pursuant to bankruptcy laws, liquidation or any other marshalling of the assets and liabilities of the Corporation; but payment of the same shall remain subordinate as hereinabove set forth.

Default in the payment of interest or principal shall not accelerate the maturity of the obligation and payment of the obligation shall remain subordinate as hereinabove set forth.

The registered holder agrees that so long as the Corporation continues as a member corporation of the New York Stock Exchange, he will not, without the prior written approval of said Exchange, transfer, sell, assign, pledge or otherwise create, or permit to be created, any lien, charge or encumbrance upon this instrument.

The term "the Corporation", as used in this agreement shall mean Weis, Voisin, Cannon, Inc., or any successor thereto.

This agreement shall be binding upon the registered holder, his, their or its heirs, executors, administrators, successors and assigns.

This agreement shall be effective on the date it is approved by the New York Stock Exchange.

IN WITNESS WHEREOF the parties hereto have set their hands and seals this 28th day of June, 1967.

WEIS, VOISIN, CANNON, INC.

(Corporate Seal)

TWO Year Debenture Bond

By _____ Secretary

A67

WEIS, VOISIN, CANNON, INC.

TWO YEAR

Debenture Bond

$ 15,000

REGISTERED OWNER MAY NOT SELL, ASSIGN, PLEDGE OR TRANSFER THE WITHIN DEBENTURE BOND WITHOUT THE PRIOR APPROVAL OF THE NEW YORK STOCK EXCHANGE

NOTICE—No writing on this Debenture Bond or any to be made except by an officer of the Corporation

DATE OF REGISTRY NAME AND ADDRESS OF REGISTERED HOLDER AUTHORIZED OFFICER

EXHIBIT C

Weis, Voisin, Cannon, Inc.
Established 1927
Members New York Stock Exchange
Members American Stock Exchange
And Other Principal Exchanges

NEW YORK
111 BROADWAY
NEW YORK, N.Y. 10006
WO 4-7300

CHICAGO
50 W. ADAMS
CHICAGO, ILLINOIS 60603
641-0500

Mrs. Eva Grossmann
5840 N. Sheridan Rd.
Chicago, Ill.

ACCT. NO.

DATE: 7-2-69

WE HAVE THIS DAY (RECEIVED ☐ DELIVERED ☐) FOR YOUR ACCOUNT. (☒ CREDIT ☐ DEBIT) YOUR ACCOUNT

DESCRIPTION	AMOUNT
Check Received 7-2-69 for Debenture Account of Customer	$5,000.00
Check and receipt to be sent to Mr. Harold Federbush in New York Office	

WEIS, VOISIN, CANNON INC.

mk

BY _____

WEIS, VOISIN, CANNON, INC.
ESTABLISHED 1927
MEMBERS NEW YORK AND AMERICAN STOCK EXCHANGES
AND PRINCIPAL COMMODITY EXCHANGES
141 W. JACKSON BOULEVARD • CHICAGO, ILL. 60604
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MAIN OFFICE
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BRANCH OFFICES
REGENCY TOWERS
63RD ST. & 2ND AVE., N. Y. C.
MID TOWN OFFICE
1385 BROADWAY, N. Y. C.
CHICAGO, ILLINOIS
NEW HAVEN, CONN.
ENGLEWOOD, N. J.
MAPLEWOOD, N. J.
FORT LEE, N. Y.
CEDARHURST, N. Y.
NANUET, N. Y.
MIAMI BEACH, FLA.

June 18, 1969

EXHIBIT D

Mrs. Eva Grossmann
5840 N. Sheridan Road
Apartment 305
Chicago, Illinois

Dear Mrs. Grossman:

At Mr. Leo Meisselman's suggestion, enclosed is renewal of the Subordinated Debenture which will mature on July 1, 1969.

Please sign the Agreement on the second page and return to me in the enclosed envelope.

Thank you for your continued interest in this Corporation.

Very truly yours,

WEIS, VOISIN, CANNON, INC.
S/ Lillian Brage
Lillian Brage

LB:kb
Enclosures:

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In the Matter of WEIS SECURITIES, INC., Debtor.	73 Civ. 2332

STATEMENT OF MATERIAL FACTS AS TO WHICH THERE IS A GENUINE ISSUE.

Pursuant to Rule 9(g) of the Local Rules of this Court, William J. Scott, Attorney General of the State of Illinois, ex rel. EVA GROSSMANN, submits the following statement of facts material to the motion for summary judgment as to which there is a genuine issue of facts to be tried:

1. The circumstances under which Mrs. Eva Grossmann was induced to invest her life savings in the sum of Twenty Thousand Dollars ($20,000) in subordinated debentures of Weis, Voisin & Cannon, and the manner in which the transaction was executed, including the application supposedly filed by Mrs. Grossmann with the New York Stock Exchange.

2. The automatic renewal of the debentures by Weis, Voisin & Cannon, without any notification of Mrs. Grossmann.

3. The absence of delivery to Mrs. Grossmann of the $5,000 debenture.

4. The taking over of Weis, Voisin & Cannon by Weis Securities, Inc., without any notification of Mrs. Grossmann.

5. The failure of the New York Stock Exchange to properly supervise and control Weis, Voisin & Cannon and Weis Securities, Inc.

6. The time when Mrs. Grossmann learned of the bankruptcy of Weis, Voisin & Cannon and Weis Securities, Inc.

DATED: February 21, 1975

WILLIAM J. SCOTT
Attorney General
of the State of Illinois
ex rel. Eva Grossman
By: s/ Fred F. Herzog,

Fred F. Herzog
First Assistant Attorney General
160 North LaSalle Street - Suite 800
Chicago, Illinois 60601
(312) 793-2457

STATE OF ILLINOIS }
COUNTY OF COOK } SS

AFFIDAVIT OF EVA GROSSMANN

EVA GROSSMANN, of 5650 North Sheridan Road, Chicago, Illinois 60660, after having been duly sworn, upon oath, deposes and says:

1. This affidavit is submitted in opposition to the Trustee's motion for summary judgment and in support of affiant's claim herein.

2. I was born in Cluj, Romania, on July 29, 1922. After having attended the grammar and high schools in Cluj, Romania, I was taken by the Nazis in 1943 to the infamous concentration camp in Auschwitz as slave laborer. I remained in that camp until September, 1943, when I was transported as slave laborer to a camp in Czechoslovakia, where I worked in a German munitions factory. I was freed in June, 1944, by the advancing Russian army. Having returned to Romania, I married in October, 1947, Ernest Grossmann.

3. After my husband and I had left Romania, we emigrated to the United States in 1950. Shortly after my arrival in Chicago I obtained a job as a fitter in the Charles A. Stevens Department Store in Chicago, Illinois. With the exception of two years I have worked continuously on the same job from that time on, and I am still presently employed as a fitter at Charles A. Stevens.

4. My husband, who had worked as a bookkeeper in Chicago, passed away in March of 1967. We both had accumulated savings in the amount of $15,000. After his death I received, in addition thereto, $5,000 from a life insurance policy which my husband had taken out for my benefit.

5. One of the customers of the Charles A. Stevens store, whom I regularly fitted, was Mrs. Leo Meiselman. She was aware of the fact that my husband had passed away and during one of the fittings she told me that her husband, who was an official of the Weis, Voisin & Cannon brokerage firm in Chicago, had invested successfully funds for several widows and had helped out other people in their investment problems. She suggested that I get in touch with him. I did so, and told him that I had a total of $20,000 available for investment purposes, which constituted mine and my husband's life savings. He in turn advised me that I invest first $15,000 and, later on, an additional $5,000, in securities of Weis, Voisin & Cannon. He explained to me that this investment was like a loan to the company. He did not mention anything of "subordinated debentures". Even if he had mentioned that term to me, I wouldn't have understood it, since I didn't know and still don't know what it meant, and what its real significance is. I thought at the time of the investment that these debentures were really nothing else but shares of stock in Weis, Voisin & Cannon, and that I owned stock in the company. I have no knowledge whatsover of finances or of the stock market, and am not familiar with any financial terms.

6. At the time when Mr. Meiselman asked me to invest my savings in the debentures he told me that this would be the best investment for me, since it would pay the highest interest. I relied and acted solely upon his advice and trusted him completely, since he was the expert in a field of which I had no knowledge whatsoever. At the time of the investment he also asked me to make out an application and to shown him proof of my citizenship. I don't know and did not ask him to whom and for what purpose the application had to be made out; I simply followed his in-

structions. I cannot recall today whether he made out the application upon information which I gave him or whether I made it out myself. Upon his prodding, I or he wrote down on the application that my financial worth was $30,000, which included the value of my furniture, some money in a checking account for living expenses, some government bonds, and some pieces of jewelry.

7. The debentures in which I had invested my $20,000 were supposedly automatically renewed; however, to my knowledge, I never received a renewal notice. I also never received a certificate for the additional $5,000 debenture, which I had bought after the purchase of the $15,000 debenture, again upon the advice of Mr. Meiselman. I received quarterly checks, first in the amount of 8%, and later in the amount of 9% as interest on the debentures.

8. In 1971, I learned that Mr. Meiselman had left Weis, Voisin & Cannon and, later on, that Weis Securities had taken over the firm of Weis, Voisin & Cannon; I never received any notification of that fact.

9. In 1972, when I once did not receive my quarterly check, I contacted Weis, Voisin & Cannon in Chicago, and was told that a Mr. Raike (I don't know the exact spelling) had taken over Mr. Meiselman's account and that no proof of my debentures could be found on the firm's records in Chicago. However, afterwards I received a phone call from Mr. Raike and he told me that matter was straightened out; I then received my interest checks again.

10. As previously indicated, I never received any notification of a renewal of the debentures or of the take-over of

Weis, Voisin & Cannon by Weis Securities. As I recall, I learned of the bankruptcy of Weis, Voisin & Cannon or Weis Securities through the newspapers in May or June, 1973.

s/ Eva Grossmann

SUBSCRIBED AND SWORN TO
before me this 21st day of
February, 1975.

Notary Public